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Lindsay, Samuel McCune

Legacies and bequests for educational, charitable...

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LEGACIES AND BEQUESTS FOR EDUCATIONAL, CHARITABLE, RELIGIOUS AND PUBLIC PURPOSES SHOULD BE FREE FROM ANY BURDEN OF THE FEDERAL ESTATE TAX

A STATEMENT BY SAMUEL MCCUNE LINDSAY, PROFESSOR OF SOCIAL LEGISLATION, COLUMBIA UNIVERSITY, ADDRESSED TO THE SENATE FINANCE COMMITTEE AND THE HOUSE WAYS AND MEANS COMMITTEE, ON BEHALF OF THE COMMITTEE ON WAR CHARITY AND SOCIAL WORK, MARCH 6, 1918.

To the
Senate Finance Committee:
House Ways and Means Committee:

There has been referred to you a Bill "to Amend the War Revenue Act in relation to Taxation of Legacies and Inheritances, and for other purposes," said Bill having been introduced in the House by the Hon. William T. Rainey, of Illinois (H. R. 9223), and in the Senate by Senator Henry F. Hollis, of New Hampshire (S. 3730). There is

also before the Ways and Means Committee another bill for the same purpose introduced in the House by Hon. Edward W. Pou, of North Carolina (H. R. 8751). These proposals seek to amend the existing Federal Estate Tax Law so that in determining the value of the net estate of residents and nonresidents of the United States for the purpose of the tax there shall be deducted from the value of the gross estate, in addition to the present allowable deductions, "all bequests, legacies, devises or gifts to the United States or to any State, or to any political division thereof, for exclusively public purposes, and all bequests, legacies, devises or gifts for uses of a religious, literary, charitable or educational character, or for the encouragement of art, or to societies for the prevention of cruelty to children or for the prevention of cruelty to animals."

One of the proposals also authorizes and directs the Secretary of the Treasury to refund, under appropriate rules and regulations, as was done under a Spanish war revenue act, the taxes collected upon that portion of net estates which represents bequests, legacies, etc., of the character described.

History of taxation of legacies and bequests.

In both particulars the proposals follow good precedents. The Act of June 27, 1902, amended the Act of June 30, 1898, "To provide ways and

1 March, 1920 - C.R.W.

means to meet war expenditures" which was the Spanish War Revenue Act and, as originally enacted, contained no exemption of gifts to educational, charitable and religious institutions, but was amended by an Act of March 2, 1901, entitled: "An Act to amend an Act entitled: 'An Act to provide ways and means to meet war expenditures, and for other purposes, approved, June 13, 1898, and to reduce taxation thereunder.' " (U.S.Stat. at Large, Vol. 31, chap. 806.) This act exempted "all bequests or legacies for uses of a religious, literary, charitable or educational character or for the encouragement of art, or legacies or bequests to societies for the prevention of cruelty to children, including all bequests or legacies of such character on which the tax imposed had not been paid or collected on the 1st day of March, 1901." An Act of June 27, 1902, gave further relief by providing for the refund of the taxes collected under the Act of 1898.

Little use has been made by the Federal Government of this source of revenue, that is of a tax on estates or inheritances in general. Throughout our history such taxation has been resorted to by the Federal Government only as a war measure and at other times has been left to the States, which have made extensive use of inheritance or estate transfer taxes. Prior to the Civil War practically the only Federal inheritance or estate taxes were the stamp

duties imposed by the Stamp Act of July 6, 1797, somewhat similar to the original English Legacy Duty which was repealed before the Act had been in operation four years. The War Revenue Act of July 1, 1862, imposed a graduated legacy tax, and an Act of July 30, 1864, increased the rates and supplemented the legacy tax by a succession tax on real estate. Apparently no exemption of legacies for charitable and public uses was made by either of these acts nor by a supplementary Act of July 13, 1866, none of which seems to have been rigidly enforced or yielded returns that indicated that they were generally observed. They were repealed by the Act of July 14, 1870. The Spanish War Revenue Act, which later exempted legacies for charitable and public uses as noted above, was repealed as far as the section imposing a tax on legacies and distributive shares on personal property is concerned by the Act of April 12, 1902.

No further experiment in this direction or use of taxation of legacies and bequests was resorted to by the Federal Government until the Revenue Act of September 8, 1916, which imposed a graduated estate tax on estates in excess of $50,000, of those who died on or after September 9, 1916. The rates imposed in this Act were increased fifty per cent by the Act of March 3, 1917, made applicable to estates of those who died on or after March 3, 1917, and

again increased by the Act of October 3, 1917, to double the rates of the Act of September 8, 1916.

Object of this proposal.

To relieve legacies and bequests for public purposes and for uses of a religious, charitable and educational character from the burden of taxation under the Revenue Acts of 1916 and 1917 and to remedy a defect in this legislation similar to that which Congress recognized in the legislation of 1898 and remedied in the legislation of 1901 and 1902, the bills herein referred to have been introduced. The remedies herein proposed are identical with those which have already received Congressional sanction, and if enacted will make the policy of the Federal Government consistent with our traditional American policy with respect to taxation which never has sought deliberately to reduce the benefits of legacies and bequests for charitable and public uses.

The policy proposed is also consistent with that followed in the legislation of thirty-four States and one territorial possession* which have inheritance tax laws, and in which bequests for educational, charitable and other public purposes are exempted in whole or in part from their operation. Five

*(Ark., Cal., Colo., Conn., Del., Idaho, Ill., Ind., Ia., Kan., Ky., La., Me., Mass., Mich., Minn., Mo., N. H., N. J., N. Y., N. C., N. D., Ohio, Okla., Ore., R. I., S. D., Tenn., Texas, Vt., Va., Wash., W. Va., Wis., and Hawaii.)

States, the District of Columbia and Alaska have no inheritance tax laws and only nine States* do not make the exemption which we here request.

The principle relied upon.

The Government should avoid taking by compulsion even a small fraction of private wealth voluntarily devoted to a public use. Otherwise it merely transfers to the public purposes of taxation, money already devoted to a public purpose, or penalizes generosity by taxing a gift, which is universally recognized as repugnant to sound policies of taxation.

Congress recognized the justice of the exemption herein proposed in another way with respect to the income tax in the revenue laws of 1916 and 1917.

President Nicholas Murray Butler, of Columbia University, in his Annual Report for 1917, has very well described this precedent as follows:

> The Congress of the United States, in drafting the War Revenue Act, has wisely provided that contributions or gifts actually made within a given year to corporations or associations organized and operated exclusively for religious, charitable, scientific or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual, to an amount not in excess of fifteen per centum of the taxpayer's taxable net income as computed without the benefit of this provision, shall be allowable as a deduction from taxable income for that year. This is a clear and satisfactory recognition of the principle that private money contributed for public purposes shall not be taxed, at least up to the limit fixed in the statute. Complete recognition of this principle would require that private money given for public purposes should be exempt from taxation no matter what relation its amount may bear to the giver's taxable income. The limitation set by the Congress is probably due to a fear that if full recognition were given just now to this undoubtedly sound principle the Government might suffer loss through its abuse by unscrupulous persons.
>
> While recognizing this sound principle so far as it related to gifts, the Congress in the same War Revenue Act violated it by imposing an onerous and highly disadvantageous tax upon legacies and bequests to charitable, educational and religious institutions. * * * The amount which the Government will receive in revenue from these provisions, if they are kept upon the statute book, will be very small in comparison with the grave damage thereby inflicted upon the educational, philanthropic and religious institutions of the country.
>
> It would be indeed disastrous if the many and far-reaching changes that are to accompany the war and the new forms of taxation which the war will compel, took such a form as to imperil the effectiveness and even the existence of the great philanthropic and educational in-

*(Ariz., Ga., Md., Mont., Neb., Nev., Pa., Utah and Wyo.)

stitutions of the country. It is the well-established tradition of American life that all possible encouragement shall be given to those individuals and groups of individuals who labor to aid the spiritual and intellectual life of the nation or to relieve suffering and want, by building up and mantaining institutions of religion, of philanthropy and of education. * * * As a result of this wise and far-sighted policy, there have been built up in the United States, without public tax, a great group of religious, philanthropic and educational undertakings that are the glory of the country and the envy of other nations. To institutions of this kind there has been for nearly a century past a constant flow of private benefactions. Legacies and bequests made to them are, as a rule, free from the usual transfer and inheritance taxes, on the principle that these legacies and bequests represent private moneys transferred to public uses. If the effect of taxing gifts, legacies and bequests of this kind were to dry up the streams of benefaction by which so much of all that is best in the United States has heretofore been fertilized and strengthened, the result would be lamentable in the extreme.

How the present law operates.

The estate tax provisions of the revenue laws of 1916 and 1917 require the executor of every estate of every resident decedent whose gross estate exceeds in value $60,000, or whose net estate, as defined in the law, has any value in excess of the specific

exemption of $50,000, to file a tentative return within one year after the decedent's death. The tax based on the net estate is due one year after the decedent's death and is subject to a discount of five per cent per annum if paid prior to that time, and if not paid within ninety days thereafter is subject to an addition of ten per cent interest per annum on the tax from the time of the decedent's death. This requirement often adds a further burden to the tax when the executor is forced to sell securities or property under disadvantageous market conditions to get the money to pay the tax unless the estate has ample liquid assets. This fact alone operates to discourage benefactions for public uses because testators do not wish to run the risk of having their residuary estate wiped out, especially if it goes to their immediate family, or bequests to the immediate family possibly reduced because the residuary estate is not sufficient to pay the tax. A benefaction made specifically for an educational, charitable, religious, or other public use, must now be included in the net estate upon which the tax is imposed. Whether it suffers any reduction thereby will depend upon whether the residuary estate is sufficiently large to take care of the tax. If the benefaction is not made specifically to the educational, charitable or religious institution, but, as is frequently the case, the institution or public use is one

of several residuary legatees among whom the entire residuary estate is to be divided, share and share alike, then, of course, it is reduced not only by the amount of the tax upon its share of the residuary estate but must bear also its proportionate share of the tax upon the whole net estate. In any event the net result is certainly to discourage all such benefactions because of the uncertainty of the amount and incidence of the tax with respect to such benefactions. It is likewise certain that a provision to exempt such benefactions by not including them in the net estate subject to the tax would operate to encourage and stimulate benefactions being made directly to educational, charitable and religious institutions.

A summary and a parallel.

SPANISH WAR TAX LEVIED	EUROPEAN WAR TAX LEVIED
The Act of June 13, 1898, entitled: An Act to provide ways and means to meet war expenditures (The Spanish War Revenue Act), levied a legacy tax but made no exemption of property passing to public uses until amended by the Act of March 2, 1901.	The Act of September 8, 1916, entitled: An Act to increase the Revenue and for Other Purposes, imposed a graduated estate tax on net estates over $50,000, and made no exemption of property passing to public uses. It was amended by the Act of March 3, 1917, increasing each of the rates of the estate tax 50%, but again making no such exemptions, and it was further amended by the Act of October 3, 1917, entitled: An Act to provide revenue to defray war expenses and for other purposes, again increasing the rates of the

	tax, making them double those of the original tax but again making no exemption of bequests and legacies for educational, charitable and religious purposes.
EXEMPTION PROVIDED The Act of March 2, 1901, exempted "all bequests or legacies for uses of a religious, literary, charitable or educational character, or for the encouragement of art or legacies or bequests to societies for the prevention of cruelty to children, including all bequests or legacies of such character on which the tax imposed had not been paid or collected on the first day of March, 1901."	EXEMPTION PROVIDED The Hollis-Rainey Bill (S. 3730 and H. R. 9223), introduced January 24, 1918, in the House and February 5, 1918, in the Senate, proposes to make such exemption in the following language: That for the purpose of the tax the value of the net estate shall be determined (a) in the case of a resident by deducting from the value of the gross estate * * * all bequests, legacies, devises or gifts to the United States or to any State, or to any political division thereof, for exclusively public purposes, and all bequests, legacies, devises or gifts for uses of a religious, literary, charitable or educational character, or for the encouragement of art, or to societies for the prevention of cruelty to children or for the prevention of cruelty to animals.
REFUND AUTHORIZED The Act of June 27, 1902, provided "that the Secretary of the Treasury, under appropriate rules and regulations to be prescribed by him, be, and he is hereby, authorized and directed to pay, out of any money in the Treasury not otherwise appropriated, to the corporations, associations, societies, or individuals as trustees or executor,	REFUND AUTHORIZED It provides also that "the Secretary of the Treasury, under appropriate rules and regulations to be prescribed by him, be, and he is hereby, authorized and directed to pay, out of any money in the Treasury not otherwise appropriated, to the corporations, associations, societies or individuals as trustees or executors, such sums of

such sums of money as have been paid by them as taxes upon bequests or legacies for uses of a religious, literary, charitable or educational character, or for the encouragement of art, or legacies or bequests to societies for the prevention of cruelty to children under the provisions of section 29 of the Act entitled: 'An Act to provide ways and means to meet war expenditures, and for other purposes, approved June 13, 1898, and to reduce taxation thereunder.'" .U. S. Stat., at Large, Vol. 32, Chap. 1160.)

money as have been paid by them as taxation upon bequests or legacies for uses of a religious, literary, charitable or educational character, or for the encouragement of art, or legacies or bequests to societies for the prevention of cruelty to children, or for the prevention of cruelty to animals under the provisions of," etc. (the appropriate section of the Acts of September 8, 1916, March 3, 1917, and October 3, 1917).

The Pou Bill (H. R. 8751) introduced January 16, 1918, provides for such exemption in analogous language for the estate of residents and non-residents, but does not provide any refund of taxes already collected.

Not a tax-dodging proposal.

Whatever loss the exemption would cost the Government can be more than made good by additional taxes which may fall directly or indirectly upon the persons or property of the very persons who benefit by the exemption. The exemption is not only necessary in order to give educational charitable and religious institutions the support which the Government can give them by this means, but is based on sound public policy. The rates of the estate tax might be raised sufficiently to meet all of the loss incurred by the exemption and the higher rates would be accepted by the public all the more

cheerfully because of a feeling that the Government had recognized fundamental justice in refraining from taking by compulsion any part of that which an individual had already contributed to a public use. The flow of benefactions to public uses would not be half so likely to be discouraged or dried up if the exemption were granted and the rates of the estate tax again substantially increased in amount.

The benefit to be derived by the Government by the imposition and collection of this tax would be many times offset by the disadvantages to the public of crippling and preventing the growth of these genuinely public and characteristically American institutions.

It is a mistake to speak of one of these institutions as wealthy because the amount it holds in trust is relatively large. That only means that the public obligations of service which it has to meet are larger still. The endowments of an institution for education, philanthropy or religion are in no wise to be compared with the capital holdings of business organizations for profit.

Present needs urgent.

It will take a generation for the colleges and universities to recover from their present adversity. They will need all the help they can get from future bequests to take care of the debts they must accumu-

late during the war and to restore them to their former condition of efficiency. In addition to this the country will need their help and look to them for new leadership in training men for the new tasks of Government in the reconstruction that must come after the war.

Aside from some provision for the higher education and training of officers for the Army and Navy, some provision for schools for the Indians as special wards of the nation, a few land grants to the States for common schools, and colleges of agriculture and mechanical arts, and very recently some Federal aid to the States in the matter of vocational training and agricultural education, the Federal Government has borne no share of the expense of schools, colleges and universities. The State Governments, likewise, have carried only a part of the public expenditure for public schools and a still smaller proportion of that for all the various forms of higher education and technical training provided by institutions other than the common schools.

If it were proposed to abandon our traditional policy of leaving to private benevolence the chief support of higher education, the main reliance of hospitals and charitable institutions, and the only hope for the encouragement of art, and for governments to assume these obligations, then there might something be said in favor of refusing the exemption herein requested of bequests for educational, charitable, religious and public uses.

Even those who might regard the direct maintenance of such institutions as no constitutional function of the Federal Government would admit that the Government should at least refrain from putting any burden on them.

The needs of hospitals, of charitable and relief organizations of all kinds, of religious institutions, and of other organizations engaged in works of humanity and mercy are probably no less urgent than those of institutions strictly educational in character. Only, the latter have been deprived of certain definite sources of revenue and support from tuition fees received from their students in proportion as they have patriotically vied with one another in urging their students and faculties alike to give themselves freely in the military and civil service of their country. The burden upon all alike—upon education, charitable relief and the ministry of religion, is a new and increased burden by reason of the war. The need for the service which these institutions alone can render, apart from anything that the Government may or can do itself, is such now, and will be so much greater in the future when we enter upon the work of reconstruction after the war, that no wise government can afford to ignore their call for help or to refuse them every just means of encouragement and support.

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